BRITISH COLUMBIA RAILWAY COMPANY

THREE YEAR SERVICE PLAN

2002 - 2004

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BRITISH COLUMBIA RAILWAY COMPANY

SERVICE PLAN

2002 - 2004

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BRITISH COLUMBIA RAILWAY COMPANY

COMMERCIAL SENSITIVITY AND CONFIDENTIALITY

The British Columbia Railway Company is a unique, fully commercial Crown Corporation with all of its businesses operating in full competition with the private sector in a deregulated environment. This uniqueness was recognized by the Province when the British Columbia Railway Company was the only public body exempted from "Freedom of Information" legislation.

The BCR Group of Companies is extremely vulnerable to the risks of disclosing or publishing any commercially sensitive information, operational performance statistics or financial data. The public availability of such information could seriously undermine BCR's competitive position. Only consolidated, historical results are currently published in the BCR Group Annual Reports.

As a result, this public Strategic Business Plan document does not provide specific information pertaining to:

- Financial forecasts
- Performance measures and targets
- Specific business strategies
- Information on matters of competitive intelligence

The release of such information would be extremely disadvantageous to the BCR Group of Companies by providing competitors with commercial intelligence. The results of this would be detrimental to BCR Group's competitiveness and commercial viability and, ultimately, harmful to the value of the enterprise to the Province.

BRITISH COLUMBIA RAILWAY COMPANY

Overview of the Organization

The British Columbia Railway Company, also referred to as the BCR Group of Companies, is comprised of two distinct business units: BC Rail and BCR Marine. For management purposes, financial information within the BCR Group is prepared on a business unit basis rather than on the basis of individual corporate or operating entities.

BC Rail is the historic founding company of the Group and the railway continues to be the core business unit. However, during development of BC Rail's first strategic plan in 1991, it was identified that the recently deregulated Canadian transportation environment and the weak economic outlook for northeastern B.C. coal posed significant threats to the ongoing viability of BC Rail. As a result, a strategy of diversification was adopted to lessen the company's dependence solely on the railway and its predominantly resource-based traffic of coal and forest products.

In 1993, BCR Group acquired Vancouver Wharves Ltd., providing diversification into the marine terminal business and a wider range of freight commodities. In 1998, Canadian Stevedoring was acquired, providing further diversification into high-growth container traffic and the handling of other non-resource manufactured goods. Canadian Stevedoring also provides geographic diversification with its main facilities on the south shore of Burrard Inlet and stevedoring services up and down the B.C. coast. In 1999, Vancouver Wharves and Canadian Stevedoring were amalgamated into the BCR Marine business unit.

Each of the two business units prepares individual strategic plans that are reviewed in detail with the Board of Directors.

BRITISH COLUMBIA RAILWAY COMPANY

VISION

To be a strategic advantage to BCR Group customers.

MISSION

To build a reliable, cost effective group of freight transportation companies.

VALUES

- A safe and healthy work environment
- A customer-focused, market-driven approach to business
- A creative, resourceful and entrepreneurial spirit
- Continuous improvement and innovation
- Operate profitably and achieve business targets
- Treat everyone in an honest, fair and respectful manner
- Reward and recognize achievements of individuals and teams

BRITISH COLUMBIA RAILWAY COMPANY

BCR GROUP OF COMPANIES

Planning Context and Key Strategic Issues:

BCR Group creates value for the Shareholder in a number of ways. Perhaps the most important contribution is through investing in major capital infrastructure projects aimed at increasing the enterprise value of BCR. In addition to improving the value of the company, BCR Group's investments create employment opportunities in B.C.

As a fully commercial and competitive crown corporation, the BCR Group does not place any demands on public taxpayer funds while investing substantial amounts of capital for growth and diversification.

Through the Group's strategic planning process, the Board of Directors has identified three key strategic issues which must involve participation of the Shareholder. These are:

- The need to restructure BCR Group's debt
- The need to establish a clear dividend policy
- The need to significantly transform BC Rail, including a decision on the future of unprofitable passenger services

Due to Crown ownership, BCR has not been able to source any new equity capital. All growth capital, beyond that provided by earnings, has been financed with debt through the Province. As a result, BCR Group's debt level has now grown to 115% of equity. A comparable transportation company would typically have a debt/equity ratio in the range of 30% to 40%.

The challenge has been made worse by shrinking business and revenues, particularly at BC Rail. The corresponding reduced level of free cash flow is no longer adequate to cover historic levels of sustaining capital, resulting in growing debt just to sustain the physical plant. As a result, it will be essential to rationalize all facilities and other assets to ensure that they are yielding sufficient commercial returns to justify retention.

A large portion of the long term debt originates from nearly 20 years ago as part of financing BC Rail's involvement in the development of northeastern B.C. coal resources. In 2000, two-thirds of BC Rail's coal business disappeared due to premature closure of Quintette Mine. The remaining coal traffic is scheduled to cease by mid-2003. As a result, the value of all coal-related assets has been written down by some $600 million, but the issue of the lingering debt attributed to northeast coal development has not yet been addressed.

In addition to the need for re-capitalization of the BCR Group, a commercially responsible dividend policy will also be proposed by BCR's Board of Directors. The new policy will balance the Group's debt position and need for capital with the Province's requirement for dividends.

The Province also needs to review the future of mandated, unprofitable passenger services operated by BC Rail. The operating losses are a significant contributing factor to the company's reduced cash flow.

Major Capital Project Information:

Within the planning period of 2002 to 2004, there is one major capital project forecast at BC Rail. The project involves the acquisition of a new fleet of box cars dedicated for the handling of OSB from a proposed new OSB plant at Fort St. John. Estimated capital cost for the car fleet is $55 million. Commitment of this expenditure will only occur when a construction start date for the OSB plant is established and a freight transportation contract is concluded.

BRITISH COLUMBIA RAILWAY COMPANY

BC RAIL

Planning Context and Key Strategic Issues:

The continued effects of a deregulated Canadian transportation industry have stimulated many competitive factors that challenge the viability of BC Rail. The effect of these factors is now being intensified through the ongoing consolidation within the North American railway industry such as the recent mergers involving CN with two U.S. railroads, the Illinois Central and the Wisconsin Central.

As a result of deregulation, competition between transportation modes, particularly by trucking, has triggered severe industry-wide freight rate erosion. Since deregulation in 1987, BC Rail has experienced a 45% decline in its average freight rate yield, as measured by Revenues per Gross-Ton-Mile. Unlike the trucking industry, railways are burdened with a high ratio of fixed costs and are responsible for all of their own capital investment in the transportation infrastructure. As a result, cost reduction in the face of severe revenue erosion is a major challenge and focus for the entire railway industry.

The continuing trend of mergers and consolidations between major North American railways is creating new strategic pressure on BC Rail and its ability to provide competitive freight rates for B.C. products to North American destinations. In its predominant role as an originating carrier, one of BC Rail's strategic strengths has been its ability to negotiate favourable rail routings and rates amongst a variety of rail carriers competing for the traffic to its end destination. As the major railways merge or enter into closer alliances, the competitive options for reaching some key market areas have been reduced with resulting pressure on BC Rail freight rates. The issue of competitive access by smaller railways to a choice of major carriers is a key matter being reviewed by the Canadian Transportation Agency.

Global competition and market volatility for B.C. commodities carried by the railway is also creating increased challenges to the railway's ability to plan for and respond to customer needs. The economic turmoil and currency declines experienced by key Asian customers starting in late 1997 created increased volatility and eroded important

export markets which have not recovered. The resulting worldwide surplus production capacity and sharp price declines for many basic commodities placed higher cost producers, such as those located in B.C., at a serious competitive disadvantage. This was partially offset by a strong U.S. domestic economy until the start of the current recession in mid-2001, made worse in the aftermath of events on September 11th.

The forest products sector has been particularly hard hit. In the past year, BC Rail has experienced reduced lumber traffic due to the closure and consolidation of several lumber mills in the Province. The unresolved softwood lumber dispute with the U.S. is adding to further uncertainty.

The most serious threat facing BC Rail is the loss of all northeast coal traffic by June 2003. As recently as 1997, coal accounted for more than 19% of BC Rail's revenue base; in 2001, it was only 5.7%. Coal, moved in efficient unit trains, is a relatively high contribution commodity and the loss of coal revenue has drastically reduced BC Rail's operating income. A core element of BC Rail's strategic plan is to develop and add replacement traffic within the railway's service region. Unfortunately, the time horizon for implementation of this strategy was radically shortened when Quintette coal mine closed in August 2000, removing two-thirds of BC Rail's remaining coal revenue 2 ½ years earlier than expected. Securing new traffic will be a challenge in a business environment where little new capital is being invested in industries that could yield significant railway freight traffic.

Past efforts to grow revenues by increasing the railway's market share in non-coal commodities has shown that such market share gains are usually made with little or negligible profit margin. In the future, BC Rail will not aggressively pursue traffic growth in commodities that do not yield an adequate return on investment. Some existing low-margin traffic may need to be shed in the future, especially when it becomes necessary to spend new capital to sustain the business.

The productivity of the entire railway operation must continue to be improved to reduce costs in the face of declining revenues. While BC Rail has made impressive productivity improvements over the past decade, it has not kept pace with cost cutting initiatives at CN and CP Rail and this represents a growing threat to BC Rail's traffic base. This challenge is heightened by the fact that most replacement, non-coal traffic forecast over the planning period will typically yield a lower contribution margin than coal.

Operating in uniquely challenging and high cost terrain, BC Rail also faces the need to maintain a capital-intensive, high quality physical plant. While continued cost reduction and productivity improvement initiatives are necessary, the integrity of the physical plant and safety levels must be maintained.

In addition, BC Rail is burdened with the costly obligation to operate unprofitable, passenger train services without receiving any subsidy from the Province. In 2000, the operating losses from these passenger services consumed 2% of freight revenues and reduced BC Rail's operating income by some 10%. The equipment used in these services is rapidly approaching the end of its service life and requires substantial capital investment if these operations are to continue. The Province's two steam locomotives used in the Royal Hudson train service both require major rebuilding and have been removed from operation.

To deal with the above challenges, BC Rail's strategic business plan continues its focus on four key goals.

Goals and Key Objectives:

Goal 1. Retain freight traffic revenues in existing lines of business that yield positive net contribution.

Key Objectives:

- Develop new coal traffic such that coal revenues in 2004 match or exceed those in 2001
- Increase revenues earned from improved use or development of industrial land holdings
- Develop and implement a new costing and revenue management system

Goal 2. Reduce net operating expenses and eliminate lines of business that do not yield positive net contribution to increase free cash flow and retire debt.

Key Objectives:

- Rationalize BC Rail's system to reduce operating costs on the core rail network
- Divest and/or discontinue non-core transportation businesses and services
- Improve utilization and revenue yield on fleets of freight rail cars and motive power
- Achieve productivity improvements and reduce overhead costs

Goal 3. Provide competitive, consistent services valued by freight shipping customers to achieve mutual business objectives and build loyalty.

Key Objectives:

- Sustain customer service and rail freight traffic revenues throughout the plan period while organizational transformation strategies are implemented
- Integrate business systems between customers and BC Rail to provide mutual value and build loyalty
- Improve customer satisfaction monitoring through regular surveys and responding to concerns identified

Goal 4. Create the work environment and motivated work force capable of implementing and sustaining organizational transformation.

Key Objectives:

- Provide a safe and healthy work environment
- Establish open two-way communications throughout the company to sustain employee knowledge and commitment to achievement of business initiatives

BRITISH COLUMBIA RAILWAY COMPANY

BCR MARINE

Planning Context and Key Strategic Issues:

The general trend on commodity prices continues to be downward, putting more pressure on all stakeholders in the logistics chain to cut costs and increase productivity. Many of the markets in which BCR Marine operates are mature and volumes through the Port of Vancouver, with the exception of containers and specialty agri-products, are expected to remain relatively flat at best.

BCR Marine's competitors are no longer only in Vancouver or even the Pacific Northwest, but in other parts of the world (especially in South America and Asia) where low-cost production facilities (mines, pulp mills, etc.) are coming into production at costs lower than domestic B.C. producers. Increasingly, BCR Marine's costs are subject to more stringent environmental regulations, monitoring and enforcement, and the escalating pressures of urbanization are limiting waterfront land use and expansion possibilities on Burrard Inlet.

Canada's waterfront industry as a whole is hampered by an outdated labour model that has not kept pace with the realities and work-skill requirements of the modern waterfront workplace. The lack of a dedicated workforce for specific facilities results in additional costs for training, lower productivity and increased safety risks. It makes it difficult to provide a consistent workforce skilled enough to operate sophisticated equipment and operating systems. The net result is an unsustainable model with higher costs for customers.

With BCR Marine's amalgamated operations of Vancouver Wharves and Canadian Stevedoring, the company is better able to create efficiencies, increase productivity, offer a wider range of services, and help customers be more competitive. The company's diversity gives it staying power, enabling the organization to take advantage of new opportunities as they emerge. BCR Marine's various business units are well positioned as either number one or number two in their respective markets served, and they have interests in two of the major growth markets in the Port of Vancouver - containers and specialty agri-products.

BCR Marine's future will be one of slow growth. Growth will be dampened by lower volumes of mineral concentrates and forest products, compounded by reduced commodity prices. However, growth opportunities in container traffic are forecast to regain significant strength in 2003, despite 2001 experiencing the first annual decrease in container traffic volumes in more than a decade. BCR Marine is investing in the reconfiguration of its Centerm facility in order to improve overall container capacity and handling productivity. The company is also focused on building its annual tonnage in specialty agri-products now that it has fully commissioned its new handling and storage facilities at Vancouver Wharves.

BCR Marine has successfully concluded a new 21-year lease agreement with the Vancouver Port Authority to secure the future of Casco Terminals. Under the new commercial mandate of the VPA, site tenants are required to invest their own capital in facilities. Major site investment is planned to improve terminal capacity, so a long-term agreement with VPA was essential. A commercially viable long-term agreement remains to be negotiated with the Prince Rupert Port Authority for the continued operation of Fairview Terminal beyond 2002. The substantial reduction in cargoes through this terminal in recent years makes it essential that any new agreement succeed at current levels of throughput while providing upside potential for both parties.

Over the next three years, BCR Marine is poised to contribute growth to the BCR Group of Companies, helping to offset some of the declines faced at BC Rail due to the loss of northeast coal. BCR Marine expects to accomplish this growth through the following key goals.

Goals and Key Strategies:

Goal 1. Set the industry standard for customer service excellence.

Key Strategies:

- Target specific customers and provide value-enhancing services in related areas to enhance their business opportunities
- Maximize quality assurance through improved customer-service training and ISO or other appropriate quality assurance programs
- Provide technological enhancements to improve customer service
- Rationalize and reconfigure facilities / agreements to increase container capacity

Goal 2. Have the best trained, most highly motivated people in the industry.

Key Strategies:

- With each employee, complete succession planning linked to career discussions, performance evaluations, and continuous upgrading of skills and education
- Provide a competitive compensation and benefits package
- Play a continuing leadership role in improving waterfront labour relations

Goal 3. Exceed all prevailing environmental standards.

Key Strategies:

- Implement the Environmental Management System based on the five-year plan
- Participate proactively with regulators and industry in the development and enforcement of regulations

Goal 4. Achieve and maintain maximum Worker's Compensation Board merit ratings.

Key Strategies:

- Lead and support industry-wide safety initiatives
- Ensure adequate training for handling commodities with safety considerations
- Pursue strict accident investigation procedures and a performance recognition program
- Work with regulators to improve Workers' Compensation insurance program

Goal 5. Enhance competitiveness by continuous improvement.

Key Strategies:

- Improve use of under-utilized facilities, land and resources via rationalization within and among facilities
- Develop common administrative processes across BCR Marine
- Use information technology to improve efficiency of information processing and reduce costs
- Explore opportunities to improve productivity and processes, and selectively employ capital to reduce costs

Goal 6. Grow financial returns to meet or exceed shareholder expectations.

Key Strategies:

- Evaluate new opportunities with a disciplined approach and the objective of attaining a pre-tax 25% return on capital invested
- Negotiate a commercially viable contract with the Prince Rupert Port Authority for Fairview Terminal
- Prepare for renewal of the Vancouver Port Authority water lot lease due in 2002